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In the Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
APPELLANT
v.
THE STATE OIL & GAS BOARD OF MISSISSIPPI
AND COASTAL EXPLORATION, INC., ET AL.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF MISSISSIPPI

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICUS CURIAE

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QUESTION PRESENTED

Whether the ruling of the Mississippi Supreme Court that an interstate pipeline is required to purchase gas at a uniform percentage from all owners in a common pool of gas constitutes forbidden state regulation, when the ultimate consequence of the requirement will be to increase rates charged the ultimate consumers of gas in other states.

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BRIEF FOR THE UNITED STATES AND
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INTEREST OF THE UNITED STATES

Congress has charged the Federal Energy Regulatory Commission with the responsibility of administering the Natural Gas Act, 15 U.S.C. 717 *et seq.*, and the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.* See Section 402(a)(1) of the Department of Energy Organization Act, 42 U.S.C. 7172(a)(1), and Sections 501(a) and 504(b)(1) of the NGPA, 15 U.S.C. 3411(a) and 3414(b)(1).

Under the Natural Gas Act, the Commission is responsible for establishing the resale rates for natural gas at "just and reasonable" levels (Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. 717c, 717d). Under the NGPA the Commission is responsible for enforcing maximum lawful prices for

wellhead sales of natural gas established by Congress (Section 504 of the NGPA, 15 U.S.C. 3414), and for preventing interstate pipelines like appellant from passing through to their consumers the cost of gas they purchase to the extent such cost is excessive due to "fraud, abuse, or similar grounds" (Section 601(c)(2) of the NGPA, 15 U.S.C. 3431(c)(2)). In all cases, the Commission must assure that the public has an adequate supply of natural gas in the interstate market "at the lowest possible reasonable rate consistent with the maintenance of adequate service." *Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U.S. 378, 388 (1959). The state scheme upheld here interferes significantly with the discharge of these responsibilities. Cf. *Northern Natural Gas Co.* v. *State Corp. Comm'n (Northern Natural)*, 372 U.S. 584 (1963).[1]

STATEMENT

1. Appellant, Transcontinental Gas Pipe Line Corporation (Transco), is an interstate pipeline engaged in the transportation and sale for resale of natural gas in interstate commerce, subject to the Natural Gas Act, 15 U.S.C. 717 *et seq.* Until the summer of 1982, appellant had purchased gas at a uniform rate (ratably), regardless of whether it had a contract with the selling interest-owner or not, from wells producing gas from a common pool beneath the Greens Creek and East Morgantown Fields in Marion County,

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[1]Although the Commission did not participate in these state court proceedings, it did intervene in a parallel proceeding brought by appellant in federal district court seeking a declaratory order and injunctive relief against the order of the State Oil and Gas Board. *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, Civil Action No. J82-0531(L) (S. D. Miss. filed Oct. 13, 1982). The district court has not issued any final decision in that case. On December 7, 1984, Coastal Exploration, Inc., moved to dismiss the suit on the ground that the decision of the Mississippi Supreme Court in the instant case res judicata or collateral estoppel effect should be accorded.

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Mississippi. Appellant's contracts with some of the interest-owners contained "take-or-pay" clauses (J.S. 4).[2] The gas in this common pool was all "high-cost natural gas" (or Section 107 gas) not subject to price control (15 U.S.C. 3317, 3331(b)).[3] In the spring of 1982, appellant began to experience problems selling this high cost gas to its interstate system-supply customers because end-use industrial customers were switching from gas to cheaper fuel oil (J.S. 6). As a result, in May 1982, appellant announced it would no longer take or purchase gas from the owners and producers with whom it did not have gas purchase contracts. *Ibid.*

Coastal Exploration, Inc., and other non-contract working interest owners thereupon petitioned the Mississippi Oil and Gas Board to enforce its Rule 48 (a ratable take rule),[4] by requiring appellant to purchase gas ratably from all the producers, even those with which appellant had no contracts. Appellant argued that the Board should, instead, reduce the "allowables" for the reservoir—*i.e.*, the maximum permissible production[5] — to reflect market demand

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[2]A "take-or-pay" clause in a gas contract requires the purchaser to pay for a specified volume of gas which the producer-seller has available for delivery, regardless of whether the purchaser takes the gas or not. Under such a clause the purchaser usually has the right to take the gas paid for (but undelivered) in succeeding years.

[3]Section 107(c)(1) of the Natural Gas Policy Act (NGPA), 15 U.S.C. 3317(c)(1), defines "high-cost natural gas" as gas produced from wells begun after February 1977 at completion locations deeper than 15,000 feet. Under Section 121(b) of the NGPA, 15 U.S.C. 3331(b), the "first sale" (*i.e.*, field or wellhead) price of such gas is not subject to price controls.

[4]That rule provides (J.S. 7):

> Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply.

[5]In Mississippi the allowables for gas reservoirs are established at the maximum amount of gas a reservoir is capable of producing. See Miss. Code Ann. § 53-1-1 (1972), n.6, *infra*.

or, alternatively, should allocate ratably to all producers the volumes appellant was obliged by contract to purchase. The Board rejected these alternatives. Instead, it granted the producers' petition, requiring appellant to purchase the reservoir's full allowables ratably from all producers (J.S. App. 104a-113a). The Board also ruled that appellant must purchase all such gas—even the volumes of gas that it had not contracted to purchase—under non-discriminatory price and take-or-pay conditions (*id.* at 112a).

2. On June 28, 1983, the Mississippi State Circuit Court for the First Judicial District of Hinds County affirmed the Board's order (J.S. App. 59a-103a). That court found that the order did not violate this Court's decision in *Northern Natural* or invade the Commission's regulatory authority because, in the court's view, Section 601 of the NGPA (15 U.S.C. 3431) had eliminated Commission jurisdiction over wellhead sales, thereby creating a vacuum into which the states could step. In the words of the circuit court (J.S. App. 73a-74a):

> Under the Section 601 statutory scheme, Section 601(a)(1) removes FERC's NGA-jurisdiction to directly or indirectly control or regulate a pipeline's purchase of Section 107 gas and the price paid by the pipeline for that gas. In place of that "lost" jurisdiction over the pipeline's purchases of that gas, Section 601(c) gives FERC the jurisdiction and power to deny a pipeline a pass-through of the price the pipeline pays for 107 gas, but *only* if FERC can prove that the price results from "fraud, abuse or similar grounds." Moreover, FERC's power to deny the pipeline a pass-through can be exercised *only* against the pipeline and only when (and if) the pipeline comes before FERC to obtain authority to pass-through the entire price paid by the pipeline and include that price in the resale rates charged by the

> pipeline to consumers. However, FERC still has no authority or jurisdiction (not even under Section 601(c)) to regulate or control a pipeline's purchase of 107 gas, or the price the pipeline pays to producers or the pipeline's contract with the producers.

The court also observed (J.S. App. 87a) that the Mississippi Code, Miss. Code Ann. § 53-1-1 (1972), specifically prohibits the Board from prorating the production from the reservoir according to market demand, as appellant had suggested.[6]

3. On September 5, 1984, the Mississippi Supreme Court reversed the Board's order to the extent it proscribed differences in wellhead prices, because, in the court's view, the Mississippi legislature had not authorized the Board to set prices for gas at the wellhead (J.S. App. 48a-55a). The court affirmed in all other respects. It agreed with the circuit court that Section 601(a) of the NGPA had removed any impediment to state regulation posed by this Court's decision in *Northern Natural* or by the Natural Gas Act (J.S. App. 23a-29a) and that the Board had properly ordered appellant to take the full allowables ratably from all wells (J.S. App. 57a). In the words of the Mississippi Supreme Court, "[h]owever consistent a continued proscription on state regulation might have been with the theoretical

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[6]Section 53-1-1 of the Mississippi Code states (J.S. App. 87a):

> It is not the intent nor the purpose of this law to require or permit the proration or distribution of the production of oil and gas among the fields and pools of Mississippi, on the basis of market demand. It is the intent and purpose of this law to permit each and every oil and gas pool in Mississippi to be produced up to its maximum efficient rate of production, subject to the prohibition of waste as herein defined, and subject further to the enforcement and protection of the co-equal and correlative rights of the owners of a common source of oil and gas, so that each common owner may obtain his just and equitable share of production therefrom.

underpinnings of deregulation, the Congress in [the] NGPA * * * did not ban state regulation of deregulated gas." J.S. App. 29(a).

DISCUSSION

This case presents an important question concerning the scope of permissible state authority to affect resale of gas in interstate commerce within the scheme of federal regulation established by the Natural Gas Act and the NGPA. At the center of the controversy is the question of the continuing validity of this Court's decision in *Northern Natural.* There is also the discrete question whether the state scheme of regulation at issue affects interstate commerce in a way forbidden by the Commerce Clause of the United States Constitution. Both issues implicate broad concerns touching on national energy policy and warrant review by this Court.

I.

A. The Mississippi Board's order directing appellant to take gas ratably from all wells in the common pool constitutes an impermissible effort to exert leverage upon an interstate pipeline company to increase its purchases of high-cost (*i.e.,* deregulated) gas from Mississippi wells. Because take-or-pay provisions in appellant's contracts remain in effect, appellant is faced with a Hobson's choice. Its first option is to increase its purchases of the high-cost gas from all wells in the common pool to the highest level at which it is contractually required to purchase from any single interest-owner, and make corresponding reductions elsewhere, thereby burdening its interstate customers with high-cost gas when there is already a glut of high priced gas in the interstate market. Appellant's other option is no more attractive: it can reduce the volume of its purchases from the interest-owners with whom it has contracts, and limit its purchases from the other interest-owners in the pool to like

percentages, thereby incurring take-or-pay liability for the volumes it fails to take under its contracts and similarly burdening its interstate customers with these added costs. The decision below thus imposes significant burdens on appellant's customers, and ultimately on the entire gas market.[7]

In *Northern Natural* this Court set aside quite similar orders requiring ratable takes from Kansas wells on the ground that the "orders necessarily deal with matters which directly affect the ability of the Federal Power Commission [now FERC] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." 372 U.S. at 91-92. This Court explained (*id.* at 92) that:

> [t]he danger of interference with the federal regulatory scheme arises because these orders are unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce * * *. Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States.

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[7]Take-or-pay contract clauses are common in natural gas contracts (J.S. 4 n.3), and states have frequently adopted ratable take requirements. See *Northern Natural,* 372 U.S. at 101 n.3 (Harlan, J., dissenting), noting that "[m]ost of the more important oil and gas producing States have long had statutes providing for ratable taking by *purchasers"* (emphasis in original). Thus, unless this Court reverses the decision below, many other pipelines are likely to be faced with appellant's dilemma with a resulting significant increase in prices throughout the gas market.

Accordingly, this Court invalidated the Kansas orders as "invad[ing] the federal agency's exclusive domain." *Ibid.*

In *Maryland* v. *Louisiana,* 451 U.S. 725, 751 (1981), this Court reaffirmed its holding in *Northern Natural* in invalidating a state statute that "interfere[d] with the FERC's authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers." 451 U.S. at 749. There too, this Court held that the state statute was preempted by the Natural Gas Act because it effectively "shift[ed] the incidence of certain expenses * * * to the ultimate consumer of the processed gas without the prior approval of the FERC" (451 U.S. at 750); see also *Exxon Corp.* v. *Eagerton,* 462 U.S. 176, 185 (1983). Since the order of the Mississippi Board in the instant case has the same effect, it too "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" (*Hines* v. *Davidowitz,* 312 U.S. 52, 67 (1941)) in this field and "must give way" to the federal scheme. *Maryland* v. *Louisiana,* 451 U.S. at 751; *Exxon Corp.* v. *Eagerton, supra.*

B. Contrary to the view of the courts below, Section 601(a) of the NGPA, 15 U.S.C. 3431(a), did not undermine *Northern Natural,* or the principles there articulated. The NGPA did not open a gap for state regulation of the price of deregulated gas.

1. The NGPA was enacted in large measure to eliminate the bifurcated pricing system between the interstate and intrastate markets for sale of gas engendered by the decision in *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954), that independent producers selling gas for resale in the interstate market were "natural-gas companies" under Section 2(6) of the Natural Gas Act, 15 U.S.C. 717a(6). See *e. g.,* S. Rep. 95-436, 95th Cong., 1st. Sess. 7-9 (1977); H.R. Rep. 95-496, 95th Cong., 1st Sess. Pt. 4, at 89-90 (1977);

See also H.R. 8444, 95th Cong., 1st Sess. § 2 (1977) (Findings and Statement of Purposes).[8] The NGPA met the *Phillips* problem in two ways. First, in Title I of the NGPA, "Wellhead Pricing," Congress created a comprehensive set of tiered "maximum lawful" (*i.e.*, ceiling) prices applicable to all "first sales" (*i.e.*, field or wellhead sales) for both the interstate and intrastate markets, with certain categories of gas, like the deregulated Section 107 gas at issue here, freed from price controls altogether. Second, in Section 601(a) of the NGPA (15 U.S.C. 3431(a)) entitled "Coordination With The Natural Gas Act," Congress provided that the Commission's jurisdiction under the Natural Gas Act should not apply "solely by reason of any first sale" of such deregulated gas. The manifest purpose of Section 601(a) was to exclude the first sale by independent producers of certain gas, like deregulated Section 107 gas, from the certification and tariff (wellhead pricing) authority of the Commission under the Natural Gas Act that had resulted from the decision in *Phillips Petroleum Co.* v. *Wisconsin, supra.*[9] There is not

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[8]As a consequence of the decision in the *Phillips* case, independent producers of natural gas were required to obtain certificates of convenience and necessity from the Commission under Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c), in order to sell their gas in interstate markets. Accordingly, producers filed their gas sales contracts with the Commission as part of their certificate applications, and the Commission then reviewed those contracts to insure that the contract prices for the sale of gas was not set at rates higher that those determined by the Commission to be "just and reasonable." In addition, under Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b), producers were prohibited from abandoning those certificated sales without first obtaining Commission approval.

[9]This narrow purpose of Section 601(a) is confirmed by the cross-reference to its provisions in Section 315 of the NGPA, 15 U.S.C. 3375. Section 315 reserves certain limited authority to the Commission to deal with deregulated gas despite Section 601(a) by establishing minimum contract durations for first sales, a matter that would previously have been established pursuant to the Commission's certification authority under Section 7 of the Natural Gas Act, 15 U.S.C. 717f (see n. 8, *supra*). It also replaces Commission abandonment authority with self-

the slightest indication that Section 601(a) was intended to go further and abrogate the Commission's traditional Natural Gas Act responsiblility to regulate the relationship between a pipeline and its system customers, the responsibility implicated here and in this Court's decision in *Northern Natural.* See *Public Service Comm'n* v. *Mid-Louisiana Gas Co.,* 463 U.S. 319, 336-337 (1983); *Exxon Corp.* v. *Eagerton,* 462 U.S. at 184-186; *Northern Natural,* 372 U.S. at 92; *Columbia Gas Development Corp.* v. *FERC,* 651 F.2d 1146, 1149-1150 (5th Cir. 1981).

2. Nor is there any basis to conclude that the restriction on Commission jurisdiction imposed by Section 601(a) somehow opens the way for state regulation which is tantamount to price regulation at the wellhead.[10] Under Title I of the NGPA, Congress obviously occupied the field of wellhead pricing, establishing certain categories of deregulated gas, like Section 107 gas, to stimulate supplies that are truly at the limit of economic recovery by making them free from both federal and state price controls.[11]

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implementing procedures requiring a seller desiring to abandon service to a buyer to make a bona fide offer to continue the sale of the gas to the buyer at or below the lawful maximum price and extending to the buyer a right of first refusal over any subsequent bona fide offer the seller receives. Thus, Section 601(a) is a part of a carefully limited restructuring of the Commission's authority in a new, integrated regulatory system; it does not simply create a gap in regulatory authority, to be filled in at the state's option.

[10]While the decision of the Mississippi Supreme Court set aside the Board's order to the extent it explicitly established a price for the sale of gas, the Board's order requiring purchase of decontrolled gas nonetheless has a price maintenance effect on appellant's customers. See pp. 6-7, *supra*; *Northern Natural,* 372 U.S. at 91-92.

[11]As this Court explained in *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Comm'n,* 461 U.S. 375, 384 (1983) (emphasis in original): "a federal decision to forgo regulation in a given area may imply an authoritative federal determination that the area is best left unregulated, and in that event would have as much pre-emptive force as a decision to regulate." The legislative history of the NGPA reflects just

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Indeed, when Congress intended to allocate regulatory authority to the states in the NGPA, it clearly knew how to do so. In Section 602(a) of the Act, 15 U.S.C. 3432(a) Congress allowed states to impose price ceilings (less than the NGPA maximum price, but not higher) over first sales of gas, but only if the gas is produced and sold in *intrastate commerce*. See, H.R. Conf. Rep. 95-1752, 95th Cong., 2d Sess. 124-125 (1978). This Court has explained that under this provision the states are limited to establishing maximum prices for intrastate sales "in accordance with the overall national policy." *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.*, 459 U.S. 400, 421 (1983); *Exxon Corp.* v. *Eagerton*, 462 U.S. at 186-187.

In sum, the enactment of Section 601(a) provides no warrant for attributing to Congress the intent " 'to paralyze with one hand what it sought to promote with the other' " (*American Paper Institute, Inc.* v. *American Electric Power Service Corp.*, 461 U.S. 402, 421 (1983), quoting *Clark* v. *Uebersee Finanz-Korporation, A.G.*, 332 U.S. 480, 489 (1947)), by granting the states the regulatory authority here found to exist. Instead, reading Section 601(a) in light of its purpose and the comprehensive scheme of Title I of the NGPA, it is apparent that the Mississippi Board's order, which has the effect of regulating the price and volume of Mississippi gas passing into interstate commerce, conflicts with the NGPA and therefore must give way to that statutory scheme. *Maryland* v. *Louisiana, supra; Exxon Corp.* v. *Eagerton, supra.*

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such a determination with regard to Section 107 gas. See 124 Cong. Rec. 28633 (1978) (remarks of Sen. Jackson in presenting conference report) ("Our objective was to target the revenues a producer can expect to receive from production from a given well. We wanted to elicit the maximum supply response at a minimum cost to consumers. For example, the most expensive kinds of wells to drill, those over 15,000 feet in depth, are deregulated * * * [because] they deserve the maximum economic incentive.").

II.

Even placing the federal statutory structure to one side, the Board's order is nonetheless flawed because it unduly burdens interstate commerce. While the state court decisions are based on the theory that the purpose of the challenged order is to ensure that one Mississippi producer is not discriminated against in favor of another producer in the same pool of natural gas, the inescapable impact of that order is far broader. It either forces additional volumes of high-cost natural gas into interstate channels, thereby increasing gas costs and gas volumes, or it imposes on consumers in other states increased rates due to appellant's contractual take-or-pay liability to Mississippi producers. In either case, the order has more than an "incidental effect" on appellants' interstate customers, and on producers in other states. See *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). Judged by its practical consequences, the order is plainly not a legitimate conservation measure, see *Northern Natural,* 372 U.S. at 93-94; instead, it reflects the very type of economic protectionism that has been uniformly outlawed as an impermissible burden on interstate commerce. See *Arkansas Louisiana Gas Co.* v. *Hall,* 453 U.S. 571, 580-582 (1981); *Maryland* v. *Louisiana,* 451 U.S. at 753-760; *City of Philadelphia* v. *New Jersey,* 437 U.S. 617 (1978). In short, the Board's order is a regulation of interstate commerce—one that stands on no better footing than the type of minimum price regulation this Court has already held invalid. *Cities Service Gas Co.* v. *State Corporation Comm'n,* 355 U.S. 391 (1958); *Northern Natural Gas Co.* v. *State Corp. Comm'n, supra.*

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

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